In the Supreme Court of the United States

OCTOBER TERM 1944.

No. 342.

ROBERT R. YOUNG,
Petitioner,

vs.

THE HIGBEE COMPANY,
WILLIAM W. BOAG and J. F. POTTS,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

BRIEF OF RESPONDENT J. F. POTTS

In Answer to Brief of
The Securities and Exchange Commission.

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INTRODUCTORY.

This Brief is in answer to the Brief filed by The Securities and Exchange Commission.

THE SINGULAR (AND CONTRADICTORY) POSITIONS TAKEN BY S. E. C. THROUGHOUT THIS LITIGATION.

Inasmuch as the Securities Exchange Commission (without becoming a party to this proceeding, or to the appeal) has now filed a Brief which it asks the Court to consider (if not filed as of right, then as *amicus curiae*), in which it strongly supports the position of the Petitioner, it may not be inappropriate to point out some of the

astonishing inconsistencies which have characterized its attitude in this proceeding.

1. At the outset it cordially approved the Amended Plan of Reorganization, and recommended its confirmation.

This is conceded in its Brief. (p. 3)

2. After Potts and Boag had filed their appeal, it approved the dismissal of the appeal, when that controversy was before the Sixth Circuit Court of Appeals.

The S. E. C. is discreetly silent about this in its brief, but the facts are in the record too plainly for dispute.

At the very time the Petitioner Young was objecting to dismissal of the Potts-Boag appeal, and seeking to intervene allegedly on behalf of himself and all of the other Preferred Stockholders, the S. E. C. sent a telegram to the Circuit Court of Appeals approving dismissal of the appeal. This appears in the testimony:

"Q. Proceed.

A. Yes; there was one other matter * * * A telegram, which Judge Simons showed to all of us, came to him from the Securities and Exchange Commission in which they stated that they had received no notice of the application to dismiss, but that in their opinion the plan was fair and equitable * * *

Q. Proceed, Mr. Wykoff.

A. Well, all I intend to say in this recital is that Judge Simons read the telegram to us." (Testimony of Wykoff, 22, 23.)

The Telegram is in evidence. (79, 80.)

"A. J. W. MENZIES, CLERK
UNITED STATES CIRCUIT COURT OF APPEALS
FEDERAL BUILDING
CINCINNATI, OHIO

RE: THE HIGBEE COMPANY

SECURITIES AND EXCHANGE COMMISSION NOT NOTIFIED UNTIL TODAY OF MOTION TO DISMISS APPEAL FROM ORDER CONFIRMING REORGANIZATION PLAN ALTHOUGH COMMISSION IS A PARTY TO THE PROCEEDING.

NO OBJECTION TO DISMISSAL OF APPEAL, HOWEVER, SINCE WE CONSIDER PLAN FAIR AND FEASIBLE FOR REASONS OUTLINED IN OUR ADVISORY REPORT.

SECURITIES AND EXCHANGE COMMISSION
Richard B. Ainsworth, Attorney,
Cleveland Regional Office."

This approval of the dismissal by S. E. C. was made the subject of Special Finding No. 34 (245).

3. After the Potts-Boag appeal had been dismissed by the Circuit Court of Appeals, and Potts filed an application asking fees for his work in reorganization, S. E. C. took the position that Potts had represented nobody but himself.

In order to understand this point, it is necessary to point out that after the Potts-Boag appeal had been dismissed, a claim was made by Potts and by his lawyer John H. McNeal, that they were entitled to a substantial allowance because of the great improvement in treatment which had been achieved for the security holders as a result of their services.

In other words, the final Amended Plan of Reorganization was much more favorable to the Preferred Stockholders than the original Plan.

This application by Potts for fees was disallowed by the Master, and the disallowance was adopted and confirmed by the District Court.

But in the proceedings on this application, the S. E. C. took the position that Potts—in real truth—in the proceed-

ings, had represented nobody but himself. That seems rather curious in the light of its present contentions.

At any rate, this is what S. E. C. said *at that time.*

"We believe that it will assist the Court if we briefly recapitulate the facts and circumstances which provide the background for the issues presented by the objections which Potts and McNeal have filed to the Master's reports. * * *

The applicant (Potts) has testified in substance that he resigned (from the New Preferred Stockholders Committee) because of differences which he had with the committee concerning the 1940 plan, several features of which he disapproved.

This conflicts with the version of the facts given by Mr. L. A. Bloomfield of counsel for the committee. Mr. Bloomfield testified that 'the basic reason that Mr. Potts and Mr. Boag left the Preferred Stockholders' Committee, for which we were counsel, was that both Judge Orr and myself were convinced that Mr. Potts was *not* representing all the preferred stockholders, and *we finally reached the conclusion that Mr. Potts was representing himself.*'

The events which transpired subsequently, tend to confirm Mr. Bloomfield's explanation." (From Memorandum filed by S. E. C. opposing allowance of fees to Potts, 216, 217.)

In other words, at that time, the S. E. C. was taking the position that Mr. Bloomfield, the lawyer for the committee, was right when he said that Potts did not represent anybody but himself; and that therefore it would be improper for him to be paid any fees for his acts.

4. It conceded (in the same memorandum) that the money received by Potts and Boag had no relationship to the merits of the appeal.

"As a result of circumstances in no way related to its merits, the appeal suddenly acquired a substantial nuisance value." (Memorandum of S. E. C. 218.)

5. When the Petitioner Young filed the application which is the basis for this proceeding, the S. E. C. asserted that the District Court had no jurisdiction to entertain it.

At the outset of the hearing before the Master, counsel for S. E. C. made the following statement:

> "Mr. Nordstrom: * * * The position of the Commission is the same as it has been in the past * * * and if this application is, as I understand it, an application only for an accounting in behalf of the preferred shareholders, that we believe that the Court is without jurisdiction to consider that matter." (9.)

6. The S. E. C. took no exceptions to the report of the Master; and made no appearance either before the District Judge or before the Circuit Court of Appeals.

Now—in the Supreme Court of the United States—for the first time—it contends that the matter is of tremendous importance, although it was not of enough importance for it to appear or to take any part in the lower courts.

Now—for the first time—it contends that the dismissal of the appeal was a dreadful wrong to the Preferred Stockholders, although it sent a telegram to the Circuit Court of Appeals approving the dismissal at the time that question was being considered.

Now—for the first time—it contends that Potts and Boag in filing the appeal were acting as fiduciaries and in a representative capacity, although when Potts was asking for fees for his championing the cause of the Preferred Stockholders at a time when he was concededly a member of and active in one of the Committees, the S. E. C. poohpoohed his claims and said in its Memorandum that it agreed with the counsel for the committee that Potts really never represented anybody but himself.

SOME MISSTATEMENTS OF FACT.

There are a few statements in the Brief of S. E. C. that seem to us inaccurate or seriously misleading, and which therefore require comment.

> 1. "For the purpose of this brief, we assume that the court below was correct in holding that Potts and Boag, as a committee, never received specific authority from other stockholders." (S. E. C. Brief, p. 5.)

This apparent concession is, in fact, a seriously misleading half-truth.

The language would imply that the court did not decide squarely whether "Potts and Boag, as a committee" may have received *implied* authority, or *inferential* authority.

The facts are plainly otherwise.

The Master found (and the District Court confirmed) that Potts and Boag were not a "Committee" at all in taking their appeal; and that they were acting only for themselves.

> "10. Upon their resignation as members of said Committee, Potts and Boag solicited the support of other preferred stockholders to join them in opposing the provisions of the Amended Plan of Reorganization * * *; which solicitation was unsuccessful and no one joined with, or authorized Potts and Boag to act for them.
>
> 11. Thereafter * * * Potts and Boag, *solely in their individual capacities* and not as representing other interests or rights, prosecuted their objection and exceptions to the confirmation of the Amended Plan of Reorganization.
>
> * * * * *
>
> 18. On November 14, 1941, Potts and Boag, *acting on behalf of themselves only*, appealed to the U. S. Circuit Court of Appeals * * *
>
> * * * * *
>
> 37. The evidence offered fails to show that Potts and Boag represented any other stockholders than themselves; and in the filing of objections to the con-

firmation of the Amended Plan of Reorganization, and in the prosecuting of their appeal * * * *Potts and Boag acted only for themselves individually, and not as the representatives of a class* and their appearance in these proceedings was at no time derivative in nature or effect." (241, 242, 246.)

---

2. "In failing to make any effort to prevent other security holders from being lulled into sleeping on their rights, in reliance upon the assurance that they were continuing to act for the security holders, Potts and Boag are in no position to contend that they were free to profit from the sale of their appeal by the device of appealing in their individual names." (S. E. C. Brief, p. 21.)

This paragraph makes two statements:

(a) Potts and Boag "lulled" other preferred stockholders into a feeling of confidence, so that they neglected to prosecute their own appeals, and instead slept on their rights.

(b) Potts and Boag gave, by their negative failure to inform these other share holders to the contrary, "assurance that they were continuing to act" for them.

Both statements are erroneous.

How, for example, could Potts and Boag "lull" Petitioner Young into a sense of security, when Petitioner Young did not want the appeal filed, and specifically refused to have anything to do with their objections? (Special Finding of Fact No. 13, R. p. 242.)

How could Potts and Boag "lull" any of the other Preferred Stockholders into a sense of security, so that they slept on their rights, and neglected to prosecute appeals, when every one of them (like Petitioner Young) was in favor of the Amended Plan? and wanted it to go into effect?

All this talk about the Preferred Stockholders who were "lulled" into a false sense of security is so much

nonsense. They all refused to help Potts and Boag in his opposition to the Amended Plan. They were all in favor of the Amended Plan.

As the District Judge puts it:

> "**All preferred shareholders accepted the plan of reorganization after amendment in several respects, except these applicants** (Potts and Boag). (Memorandum of Judge Jones, p. 221.)
>
> "The Higbee Company plan of reorganization long since has been confirmed, and *was acceptable to every interest except to Preferred Stockholders Potts and Boag*, who appealed from the order of confirmation of this court. * * *" (Memorandum of Judge Jones, 252.)

If it is true as the District Judge says that "all preferred shareholders * * * except these applicants" Potts and Boag were satisfied with and approved the Amended Plan, how could they be "lulled" into "sleeping on their rights" by the fact that Potts and Boag did not send them all affirmative statement that he was acting only for himself.

> 3. "In this case Potts and Boag, by jettisoning the rights of others for their own gain, brought about a result which violates a fundamental principle of bankruptcy reorganization * * *." (S. E. C. Brief, 21, 22.)

Can a man who approves a plan of reorganization, and who is satisfied with it, have his "rights" "jettisoned" by the dismissal of an appeal which he did not wish filed?

We should think the answer would be in the negative.

If that is true, then certainly nobody had his rights "jettisoned."

ARGUMENT.

In the portion of its brief devoted to "Argument," the S. E. C. states its case as follows:

I. The Appeal by Potts and Boag was essentially representative in character and subjected them to control of the Reorganization Court.

II. It is inequitable and contrary to the aims of Bankruptcy reorganization to permit Potts and Boag to retain the fruits of their sale of the appeal.

III. Potts and Boag should be directed to pay over to the debtor the consideration they received for selling the appeal.

I. THE APPEAL BY POTTS AND BOAG WAS ESSENTIALLY REPRESENTATIVE IN CHARACTER AND SUBJECTED THEM TO CONTROL OF THE REORGANIZATION COURT.

As we understand this claim, S. E. C. contends that irrespective of the *facts* which have been found by the lower courts, to the effect that Potts and Boag were acting only for themselves, and not in any representative or derivative capacity, nevertheless the appeal was "representative" *as a matter of law.*

In support of this contention, it makes some assertions of fact that seem to us doubtful and debatable. For example it says:

> "Had the appeal been successful and the order confirming the plan reversed, no new plan could have been confirmed unless it eliminated or reduced the amount of debt securities to be issued for the Bradley and Murphy claim. This would have improved the position of all public stockholders entitled to share in the reorganized corporation. Except for such compensation as the bankruptcy court might have awarded Potts and Boag for effecting this result, they would not have benefited to any greater degree than other preferred stockholders." (S. E. C. Brief, p. 8.)

But is this necessarily true?

This Court has indicated in *Bank v. Flershem*, 290 U. S. 504, 521, that under some circumstances security holders who have assented to a Plan which is invalidated on appeal, may *not* share in the benefits of the appeal.

In our case at bar, it might well be true that since *all* of the Preferred Stockholders (except Potts and Boag) assented to the Amended Plan of Reorganization, the only ones who could profit by a successful appeal would be the appellants themselves.

In its brief, it says also:

> "We contend that in undertaking this appeal * * * Potts and Boag * * * undertook responsibilities which they subsequently violated * * *." (S. E. C. Brief, p. 9.)

We are constrained to wonder what S. E. C. conceives to be those "responsibilities" which Potts and Boag "undertook"?

It is obvious from the contentions of its brief that S. E. C. denies the right of an individual appellant to dismiss that individual appeal for a cash consideration.

But do those "responsibilities" include the duty of prosecuting the appeal energetically, or indeed prosecuting it at all?

We concede that this case is not to be decided by the mere citation of other difficult situations. But as illustrative of the difficulties when a *court* is asked to create obligations where the *legislature* has failed to do so, we suggest the following questions.

Could Potts and Boag be criticized, if they dismissed their appeal because they found the prosecution of it burdensome and expensive?

Could they be criticized, if they dismissed it because they decided it was not meritorious?

Could they be criticized, if they dismissed it as an act of grace and kindness, or friendship for Bradley and Murphy, when they found them in a desperate financial plight, and just about to be ruined by a gang of financial pirates?

Could they be criticized, if in addition to motives of sympathy for Bradley and Murphy when they were in desperate straits, they were offered and received a modest gratuity? Such as a directorship in the Higbee Company, for example? Or a position on the legal staff of that company?

Or to reverse the situation, and thus throw additional light upon the difficulties of defining the "responsibilities" which S. E. C. asserts Potts and Boag "undertook" when they filed their individual appeal, we may suppose that Petitioner Young had won the "foot race."

Could Potts and Boag have been criticized if they had succumbed to the blandishments of *Petitioner Young* and had sold *him* the stock for the purpose of keeping the appeal alive?

One would think that if there is any merit in the contentions of S. E. C. that that sale and that profit would have been quite as reprehensible.

And suppose further that Petitioner Young had succeeded in selling out Bradley and Murphy, as he planned, and had thus acquired control of The Higbee Company, and had thereafter dismissed the appeal himself, as he undoubtedly would have sought to do.

Could Potts and Boag have been criticized for their part in *that*?

Or could Petitioner Young be criticized?

These are not merely fanciful suppositions.

They were real alternatives which faced Potts and Boag.

Petitioner Young *tried* desperately to buy the Potts and Boag stock, and offered to meet any price offered by Bradley and Murphy. Special Finding No. 26. (244.)

Indeed it was Young himself, who ran up the price on Boag's *ten* shares to $25,000 from $5,000.00.

Although Potts owned 250 shares, and Boag only 10 shares, and although Potts had assumed Boag would sell for his proportional part of the price, he (Boag) increased his demand from $5,000 to $25,000 after Young's representative made him that offer.

> "Q. Did Mr. Boag assign any reason for the increase in his price for his stock?
>
> A. Yes, he did.
>
> Q. Will you state what that reason was?
>
> A. Mr. Boag said that Mr. Purcell (Young's lawyer) had offered him $25,000 for his stock * * * and that his services were well worth $25,000 if not more * * *." (34.)

Not only did Petitioner Young offer to meet *any* offer that Potts and Boag should get from Bradley and Murphy, and personally offered Boag $25,000 for Boag's 10 shares of stock, but he also suggested to Potts a membership on the Board of Directors of The Higbee Company (47) and suggested also that Potts might file an application for compensation with the Court in the reorganization proceeding, which would probably be allowed. (47.)

One of the principal contentions in the S. E. C. brief is made in the following language:

> "3. The status of Potts and Boag as members of a protective committee precluded them from appealing solely on their own behalf. * * * We now state our reasons for agreeing with Petitioner that these past connections are sufficient in themselves to charge Potts and Boag with fiduciary responsibilities to other stockholders of the debtor.
>
> "Potts and Boag had initially voiced objections to the junior debt claim while acting in a representative capacity as members of a protective committee for the preferred stockholders. As this Court has held, protective committee members are fiduciaries bound to give loyalty and disinterested service in the interest

of those for whom they purport to act. * * * Having voluntarily assumed this status, Potts and Boag could not shuffle off their fiduciary responsibilities merely by resigning from the committee and proceeding in their own names." (S. E. C. Brief, 17-19.)

The basic fallacy underlying this argument (as we see it) is its erroneous assumption of facts.

We have no doubt that *if* the facts were as the S. E. C. brief seeks to make them, there would be some force in their contentions.

We concede that if a member of a protective committee should secretly resign from a committee, thereby misleading the persons represented by the committee, and then profit out of the situation so created, he might fairly be called to account.

But despite the assumptions of S. E. C., those simply are not the facts in our case at bar.

There was no secret about the fact that Potts and Boag had resigned from their former committee. This was not done in a corner or in a closet. It was done noisily and with publicity.

Thereafter, Potts and Boag *tried* to organize a new committee, and circulated the stockholders, *trying* to get support for their continued opposition.

This attempt was wholly unsuccessful. The third member who had authorized them to use his name in this attempt (John W. Joughin) withdrew. (186.)

Not a single one of the preferred stockholders joined with Potts and Boag. (Special Finding No. 10, p. 241.)

It is, therefore, unwarranted to *assume* that other preferred stockholders were misled, and that for this reason Potts and Boag continued to have fiduciary obligations towards the other preferred stockholders.

The Case of Sprague v. Ticonic National Bank, 307 U. S. 161.

The brief of S. E. C. attaches great importance to the *Sprague* case, *supra*, and argues that inasmuch as the appellant in that case was given *rights* against other members of a class because of her efforts and her successful appeal, that it must necessarily follow as a matter of logic that there were what the brief calls "*concomitant responsibilities*" which also attach to an individual appeal.

We submit that the logic of the *Sprague* case does not compel any such conclusion or any such results.

Just what are the "concomitant responsibilities" of an individual appeal?

As we have suggested above, this concept of "concomitant responsibilities" takes us into the field of legislation rather than judicial interpretation.

Should these "concomitant responsibilities" embrace the duty of continued prosecution?

Should they embrace the duty of *diligent* prosecution, in contradistinction to lackadaisical prosecution?

Could an appellant be charged with negligence, or his lawyers with malpractice, for incompetent or negligent conduct of the appeal?

So long as Congress has given the individual stockholder the *right* to file and prosecute his own individual appeal, we should think that it was inherent in that *right* to prosecute it or discontinue it on his own terms.

II. IT IS INEQUITABLE AND CONTRARY TO THE AIMS OF BANKRUPTCY REORGANIZATION TO PERMIT POTTS AND BOAG TO RETAIN THE FRUITS OF THEIR SALE OF THE APPEAL.

In support of this proposition the S. E. C. brief argues that the dismissal of the Potts-Boag appeal inequitably and improperly prevented a hearing of the appeal in the Circuit Court of Appeals, and thereby the other preferred stockholders were wronged.

The fallacy underlying this argument is the same which pervades the rest of the S. E. C. brief, to wit: that there were other preferred stockholders who desired the appeal to be heard.

This is the basic assumption, or major premise, of the entire S. E. C. brief.

But where is there anything in the Findings, or in the evidence, to support it?

On the contrary, it is clear that there were *not* any other such preferred stockholders who desired the appeal heard.

On this point the S. E. C. brief says:

> "Through the device of selling their securities, they prevented the appeal which they had taken on the ground that the plan was unfair, from ever reaching a hearing by an appellate Court." (S. E. C. Brief, p. 22.)

This argument (we should think) comes with singularly bad grace from the S. E. C., which sent a telegram to the Circuit Court of Appeals when the dismissal was under consideration, in which it said that it had:

> "* * * No objection to dismissal of appeal, however, since we consider plan fair and feasible." (79.)

If—despite all of the facts of the sale by Potts and Boag to Bradley and Murphy which were then known—the S. E. C. still thought it appropriate and proper to dismiss the appeal, it could well be argued that it was quite as much the action of the S. E. C. which caused the dismissal of the appeal as the acts of Potts and Boag.

III. POTTS AND BOAG SHOULD BE DIRECTED TO PAY OVER TO THE DEBTOR THE CONSIDERATION THEY RECEIVED FOR SELLING THE APPEAL.

In support of this contention, the brief of S. E. C. discusses the question of *res judicata* as follows:

"Such relief is not barred by the orders of the Circuit Court of Appeals denying Young's application to intervene and dismissing the appeal. Although Young's earlier application, like the application under consideration here, was predicated on the ground that respondents were prosecuting their appeal as representatives of the preferred stockholders, there exists no basis for *res judicata*.

"In opposition to Young's application to intervene and continue the appeal, it was properly urged that he had failed to object to the confirmation of the plan and that he had ulterior motives. Certainly in determining whether to permit Young to continue the appeal, *the Court was entitled to find that his failure to object to the plan in the lower Court estopped him from contesting its inequity at the appellate level.*

"Effective appellate administration and proper functioning of reorganization machinery both require an appellate court, in the absence of strong countervailing equities to refuse to hear objections to a plan which are offered by a person who failed to urge them in the reorganization court." (S. E. C. Brief, 32, 33.)

If the brief of S. E. C. is correct in the foregoing statement, it would seem to dispose at once of all of its contentions in its brief.

That is true because *all* of the other preferred stockholders are in the same boat with Young. Not a single one of them objected to the amended plan of reorganization —and as already pointed out in this brief, the District Court made it clear and emphatic (252, 221) that the plan was acceptable to *all* of the preferred stockholders except only Potts and Boag.

If the S. E. C. brief is right when it concedes that Petitioner Young had no right to object to dismissal, all of the others would appear to have been in the same situation exactly.

We have not taken the position that the judgment of dismissal in the Circuit Court of Appeals was—strictly speaking—a case of *res judicata.*

It is more accurately a case of collateral estoppel by judgment.

If in a case between plaintiff and defendant, two issues are involved, to wit: (A) and (B), and there is a general finding for the defendant, it follows of necessity that the plaintiff has failed on one or the other or both of these two issues; and by equal logic, it follows that the defendant has won on one or the other or both of these issues.

If in a subsequent litigation the plaintiff is in a situation where he is required to establish only one of these two issues, (A) or (B), there can be no successful collateral estoppel by judgment because of the inability to prove on which issue the defendant formerly prevailed.

But if in such subsequent litigation, it is necessary for the plaintiff to prevail on *both* issues, (A) and (B), then by equal logic the defendant must win because it is demonstrable that he has already won on at least one of the two issues with respect to *both* of which in the subsequent litigation the plaintiff must prevail if he is to win at all.

Applying that analysis to our case at bar, we have this situation: at the time the Potts-Boag appeal was dismissed, the same facts which are now in the record were before that Court.

Then, as now, it was claimed that Potts and Boag prosecuted their appeal in a representative and fiduciary capacity.

Then, as now, Potts and Boag insisted that their appeal was made in an individual capacity.

With all the facts before it the Circuit Court of Appeals held that Potts and Boag had the right to dismiss their appeal; and this judgment in turn involved the determination that (A) they had that as an unqualified right,

irrespective of any profits to them in the transaction; *or* (B) that the facts of the transaction (which are the same facts shown in this record) were not such as to establish any wrong or prejudice to the corporation or to its preferred stockholders or at any rate, to those Preferred Stockholders who had any right to complain.

In the proceeding which is now before this Court, we submit that the Petitioner can not prevail without proving *both* (A) and (B), towit, that (A) Potts and Boag did *not* have the unqualified right to dismiss their appeal; and (B) that the facts of the transaction were such as established prejudice to the corporation or to some of its Preferred Stockholders.

Inasmuch as in the former proceeding before the Circuit Court of Appeals, there was a direct adjudication against the Petitioner which of necessity was based *either* on (A) or on (B), he can not prevail now when he is required to prove both of them, to win.

IN CONCLUSION.

For the reasons presented in the foregoing Brief, and in our Original Brief filed in answer to Petitioner's Brief, we submit that the judgments of the lower courts should be affirmed.

Respectfully submitted,

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Attorneys for Respondent,
J. F. Potts.